

Internal Revenue Service

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In Re:

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B04

PLR-123250-08

Date:

November 17, 2008

LEGEND:

Trust =

Date 1 =

Date 2 =

Grantor =

Son =

Daughter =

Granddaughter =

Great-granddaughter =

County Court =

State =

Citation 1 =

Citation 2 =

Citation 3 =

Citation 4 =

Dear :

This is in response to your May 15, 2008 letter and other correspondence requesting rulings regarding the effect of the proposed judicial construction and reformation of Trust for federal estate and generation-skipping transfer (GST) tax purposes.

The facts submitted are as follows:

On Date 1, Grantor executed Trust, a revocable trust governed by the law of State, primarily for the benefit of Grantor during her lifetime and her descendants upon her death. Grantor died on Date 2 and Trust became irrevocable.

Section 7 of Trust provides, in relevant part, that upon Grantor's death, if one or more descendants of Grantor's daughter, Daughter, survives Grantor, the trustee is to set aside a pecuniary amount equal to Grantor's available federal GST tax exemption. The trustee is to hold this pecuniary amount as a separate "Exempt Trust" for the benefit of Daughter's descendants. The trustee is to divide the balance of the trust estate into separate shares among the living descendants of Grantor, per stirpes, to be held as separate "Non-Exempt Trust" for the descendant for whom it was created.

Section 8 provides, in relevant part, that the trustee is to divide the balance of the Exempt Trust into separate shares of equal value, creating one share for the benefit of Grantor's granddaughter, Granddaughter, and one share for the benefit of Grantor's great-granddaughter, Great-granddaughter.

The provisions of section 9 and 10 of Trust govern the Non-Exempt Trusts for the benefit of Grantor's two children, Son and Daughter. The provisions grant Son and Daughter the power to withdraw all or any part of the principal of their Non-Exempt Trust during their lifetimes. Both Son and Daughter exercised his or her power to withdraw the entire principal of his or her respective Non-Exempt Trust.

Section 11.a provides that the trustee of the Exempt Trusts created for a descendant of Daughter may pay to or use for the benefit of the primary beneficiary and her descendants such part of the income and principal of the trust as the Trustee deems necessary or advisable for their health, maintenance, education, and support.

Section 11.c states that:

Upon the Primary Beneficiary's death, the Trustee shall distribute the principal of any Non-Exempt Trust which would otherwise be subject to generation-skipping transfer tax upon said Primary Beneficiary's death to or in trust for the benefit of such of the Primary Beneficiary's creditors and creditors of the Primary Beneficiary's estate as said Primary Beneficiary may appoint under Will by specific reference to this power and shall distribute the principal of any Exempt Trust and any part of the principal of the Non-Exempt trust not otherwise subject to appointment to or in trust for the benefit of such of my descendants as the Primary Beneficiary may appoint under Will by specific reference to this power; any principal of the Exempt Trust or the Non-Exempt Trust not effectively appointed shall be distributed to the then living descendants, per stirpes, of the Primary Beneficiary, or if none, per stirpes, among the then living

descendants of the nearest lineal ancestor of the Primary Beneficiary who was also a descendant of mine and of whom one or more descendants are then living, or if none, to my then living descendants, per stirpes.

It is represented that Grantor intended to give the primary beneficiaries of the Exempt Trust only a testamentary limited power of appointment in order to ensure that the GST Exempt status of the trusts created for the descendants of Daughter would continue. However, the language in section 11.c of the Trust could be viewed as granting the primary beneficiary a general power of appointment. Specifically, under the terms of the testamentary power, the primary beneficiary can appoint the trust corpus to a descendant of Grantor. Since the primary beneficiary is a descendant of Grantor, the language could be viewed as allowing the primary beneficiary to appoint the trust to the primary beneficiary's estate. As noted, the trustee maintains that such a construction is contrary to Grantor's intent. Accordingly, the trustee intends to petition the County Court to reform the provisions of section 11.c of Trust. The proposed petition will request a change to the language in section 11.c to provide that the trustee:

shall distribute the principal of any Exempt Trust and any part of the principal of the Non-Exempt trust not otherwise subject to appointment to or in trust for the benefit of such of my descendants (other than the Primary Beneficiary, the Primary Beneficiary's creditors, the Primary Beneficiary's estate, and the creditors of the Primary Beneficiary's estate) as the Primary Beneficiary may appoint under Will by specific reference to this power.

You have requested the following rulings:

1. The proposed judicial reformation of section 11.c of Trust is consistent with applicable state law that would be applied by the highest court of State.
2. As a result of the proposed judicial reformation, the primary beneficiaries of the Exempt Trusts will not possess nor ever have possessed a general power of appointment with respect to the descendants' Exempt Trusts established under section 11 of Trust that would cause the value of principal of an Exempt Trust to be includible in a Grantor's descendant's gross estate for federal estate tax purposes.
3. As a result of the proposed judicial reformation, the exempt status of the Exempt Trusts for GST tax purposes will not be affected and the judicial reformation will not result in a transfer of property that will subject the Exempt Trusts, or distributions there under, to the generation-skipping transfer tax imposed under § 2601 of the Internal Revenue Code.

LAW AND ANALYSIS

Ruling 1-3

Section 2041(a)(2) provides that, for federal estate tax purposes, the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has at the time of death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment.

Section 2041(b)(1) defines the term "general power of appointment" as a power that is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate.

Section 2041(b)(2) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the person possessing the power shall be considered the release of such power.

Section 2601 imposes a tax on every generation-skipping transfer (GST) made after October 26, 1986.

A generation-skipping transfer is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip. Section 2612(a) provides that the term taxable termination means a termination (by death, lapse of time, release of a power or otherwise) of an interest in property held in trust where the property passes to a skip person with respect to the transferor of the property. Section 2612(b) provides that the term taxable distribution means any distribution from a trust to a skip person other than a taxable termination or a direct skip. Under § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax made by a transferor to a skip person.

Section 26.2601-1(b)(4)(i) of the Generation-Skipping Transfer Tax Regulations provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct scrivener's error will not cause an exempt trust to lose its exempt status provided the judicial action involves a bona fide issue, and the construction is consistent with applicable state law that would be applied by the highest court of the state.

In Commissioner v. Estate of Bosch, 387 U.S. 456, 87 S. Ct. 1776, 18 L. Ed. 2d 886 (1967), the Supreme Court considered whether a state trial court's characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute.

Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

The primary purpose in construing a will is to determine the testator's intention from the instrument as a whole and to give it effect. Citation 1. The intention of the testator is to be ascertained by examining the entire will and giving the words their plain and ordinary meaning. Citation 2. Every word, phrase and clause in a will should be given effect, if possible, and where one construction of a will would render a portion of it meaningless and another construction would give effect to all provisions and all language, the construction giving effect to the latter construction will be adopted. Citation 1; Citation 3. The same rules that govern the construction of a will apply to the construction of trust instruments. Citation 4.

It has been represented that Grantor never intended to provide the primary beneficiaries of the Exempt Trust with a general power of appointment. We agree. An examination of section 11.c of the trust instrument supports the conclusion that Grantor intended to provide the primary beneficiaries with a nongeneral power of appointment.

First, Grantor divided the Trust into two parts, the Non-Exempt Trust and the Exempt Trust. The Non-Exempt Trust was held as separate shares, one share for Son and one share for Daughter. The primary beneficiaries of the Non-Exempt Trust are nonskip persons as that term is defined in § 2613. By allowing Son and Daughter to appoint their share of the property in the Non-Exempt Trust to their creditors or the creditors of their estates, Grantor gave Son and Daughter a general power of appointment. Grantor used the exact language required under § 2041(b). If Grantor had intended to give the primary beneficiaries of the Exempt Trust a general power of appointment over their share, she would have used the same or very similar language.

Second, taxpayers frequently allocate their GST exemption to trusts that benefit future generations of the family. Generally, these trusts are not subject to the transfer tax in Subtitle B of the Code until after the trust terminates under state law. Providing the beneficiaries with a general power of appointment conflicts with this result because the power subjects the trust property to the transfer tax even if the property remains in the trust or the trust terminates and the property is distributed outright.

For the reasons above, we conclude that the proposed judicial reformation by County Court of section 11.c of Trust is consistent with applicable state law that would be applied by the highest court of State.

Further, based on the facts submitted and the representations made, we conclude that, as a result of the proposed judicial reformation, the beneficiaries of the

Exempt Trusts will not possess nor ever have possessed a general power of appointment with respect to the descendants' Exempt Trusts established under section 11 of Trust that would cause the value of the principal of an Exempt Trust to be includible in a Grantor's descendant's gross estate for federal estate tax purposes.

Finally, based on the facts submitted and the representations made, we conclude that as a result of the proposed judicial reformation, the exempt status of the Exempt Trusts for GST tax purposes will not be affected and the judicial reformation will not result in a transfer of property that will subject the Exempt Trusts, or distributions there under, to the generation-skipping transfer tax imposed under § 2601.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of provides that it may not be used or cited as precedent.

Sincerely,

James F. Hogan
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:

Copy of letter for section 6110 purposes